Speech by the Governor of the Bank of England

Given at the Lord Mayor's dinner to the bankers and merchants of the City of London on 18th October 1973

. . . Your term of office, my Lord Mayor, has coincided with a period of extraordinary economic expansion throughout the world. We have shared in this and it has brought us great benefits. The Chancellor has outlined the Government's strategy and his assessment of the present situation. You will not wish me to cover the same ground, but I should like to add something about our monetary policy. This falls to be judged in the context of the broad economic strategy and I should like to put recent actions into that perspective.

The first of these should not have surprised you. During June it was becoming increasingly apparent that the widening disparity of short-term rates between London and overseas centres would soon require action. It needed no more than the installation of a new Governor to make this inevitable. My predecessors, Lord Cromer and Lord O'Brien, both had their baptisms of fire within weeks of taking office. The variant reserved for me arrived at once when the dollar fell suddenly against the Continental 'snake' and carried sterling down with it. There was no case for a further fall in the rate for balance of payments reasons and it would have worked against the Government's anti-inflationary measures. We therefore called for further Special Deposits which, together with some expenditure of exchange, brought about a sharp upward shift in short-term rates in London. The shift achieved our primary objective of stabilising the sterling exchange rate and was also, in my judgment, appropriate to the domestic situation where a more restrictive policy was required. Apart from the external need I should have preferred a less sudden change which could have taken place without the same hurt to some. In particular I should like to pay tribute to the steady and responsible behaviour of the discount market in difficult conditions.

In September I issued guidance to the banks on the direction of their lending and asked them to limit it in the less essential areas. We saw a need to encourage an adjustment in the balance of demand as well as to support the higher interest rates in moderating the pace of monetary growth. For moderation in the rate of growth of the economy and in the pace of inflation requires moderation in the pace of monetary expansion.

It is not always easy to discern what these growth rates are. It is hard enough when dealing with the economy, but it is harder still in the monetary field. Many commentators appear to pass judgment on monetary policy almost exclusively by reference to the behaviour of the broader definition of money supply which we call M_3. This is placing more weight on a single yardstick than it is capable either in principle or in practice of bearing. Thus there has been insufficient recognition both of the extent to which in the last two years business has flowed back into the banking system following the removal of earlier restrictions, and of the effects of investors' preference for liquidity at times when the future course of inflation and interest rates has tended to be uncertain. There are other indicators, and they do not all tell the same story. The narrow definition of the money supply, M_1, which is the main focus of attention in the United States for example, has grown much less fast.

In so far as the faster growth of M_3 has been due to business flowing back into the banking system, I regard it as healthy. I find it difficult to understand those who believe that the new structural system should be abandoned, because under it the banks are able to use their comparative efficiency so as to intermediate more between borrower and lender. That was the purpose of the exercise.

But, despite all the doubts and uncertainties that abound, one has to make a judgment about the pace of monetary expansion. And looking at all the monetary statistics, and perhaps in particular at the pace and direction of bank lending to the private sector, it appeared to have been over-rapid. We acted this summer to raise interest rates sharply. The effects of this and of the guidance given to the banks take time to work through but I believe they will operate to stem the pace of monetary expansion. Hopes may be dupes but if they are – and there is a full-scale war in progress in the Middle East – we shall not hestitate to take such further action as may be necessary to secure our objectives.

I have dealt with the evolution of policy. I now turn to the framework within which it operates. But I should first state my firm belief that a framework which allows freedom for competition and innovation in the business of banking is good for British industry and commerce and, by enabling banks to play a vigorous part in the world market for finance, is of further benefit to this country.

It is some two years since the Bank introduced the arrangements set out in *Competition and credit control*. At the time, these were widely acclaimed with a chorus of assent and very little qualification, no doubt partly because people then had vividly in their minds the difficulties, rigidities and inefficiencies to which the banking system had become a victim as a result of long years of restriction. Since that time the chorus has become muted, qualifications have been entered and there are sharply dissenting views.

Yet I do not suppose that anyone would deny that our banking system – and I speak especially of the big clearing banks – today shows an altogether new vigour and enterprise. Many factors have been at work, but for myself I should want in their case to suggest disclosure, competition and credit control, and the challenge of foreign banks, as three main agents of change. All this is good.

But the new competitive environment has posed some operational problems for both the banks and the central bank, including the so-called 'merry-go-round' which has added some further, very real, distortions to the monetary series. More generally banks have needed to learn new techniques in managing their resources and both they and others dealing in financial markets have needed to acquire new skills in assessing future developments generally and the course of interest rates in particular. In the same way, we in the Bank have needed to adapt and correct our approach and techniques in the light of experience. Thus in July we amended the rules agreed with money market houses to give them greater flexibility in managing their resources without, at the same time, weakening our overall control. More recently we have reinforced the influence we can bring to bear on interest rates by operating directly in the local authority temporary money market, as a supplement to our other techniques. We are also conducting, with those concerned in the

City, a study of the practices and procedures in the sterling inter-bank and certificate of deposit markets. We shall remain ready at all times to take account of informed criticism and to make the improvements that experience convinces us are required. I am sure that this is the right way to proceed.

I want next to talk about Europe. We have now, my Lord Mayor, perhaps not entirely to your personal satisfaction, been members of the European Economic Community for nearly a year. But we are perhaps still only beginning to appreciate the full implications. Two aspects in particular affect the Bank. The first is progress towards economic and monetary union. Here we have been heavily engaged. As you will know, the embryo European central bank, in the form of the European Monetary Co-operation Fund, has been set up this year; and we now have before us a crowded programme of meetings and discussions over the move into the second stage of European Monetary Union. There often seems distressingly little output to show for all the input. But the integration of nine sovereign economies is an enormous undertaking. It is bound to be a long haul.

On the other aspect of Europe with which the Bank are concerned — the relations between the City and the Community — we have also been playing a full part from the beginning. Many of those here tonight have established excellent relationships with their opposite numbers and with the Community authorities. The British Bankers' Association, whose membership was enlarged and whose organisation was modified a year ago with accession to the Community closely in mind, is actively engaged in the discussions on the draft directive on credit institutions. And may I say how much we welcome the appointment of Lord O'Brien as President of the Association. His appointment marks the beginning of a new phase in its life, a phase which now enables it (as he advocated) to speak with one voice not only in its dealings with the Bank and Government but also with the European Economic Community. Then again, the stock exchange has established a committee to cover Community matters in the field of securities. The insurance industry has used its long established contacts as a means of study and representation. Nor have we in the Bank been idle. Notwithstanding all this activity I still doubt whether all of us have yet fully realised what membership will mean to us. I willingly confess that my own understanding has grown since July. We have a lot of explanation to do and a lot of understanding to gain. We start from different — in some ways opposite — starting points: we from a largely unwritten system, they from enacted laws. There is need for a philosophical reconciliation as well as adaptation and adjustment in practice and technique. To find solutions will test our imagination as well as our pragmatic skills. It will be useless for us to rest simply on our own established ways in all respects and to treat everything from Brussels as wrong-headed. Nor must we on the other hand 'throw up the sponge' and let ourselves be strangled by red tape in the name of harmonisation.

In all these matters I believe that the Bank and the City should work closely together and I believe that the Bank can help the City with leadership, guidance and information. With this in mind we have made some appointments in the Bank, announced today, which will increase our effectiveness by concentrating under one full-time head responsibility for all the work carried out by the Bank on E.E.C. matters in the fields of banking, insurance and capital markets, and for co-operation in these matters with the City, Whitehall and Brussels. In the coming weeks I shall be discussing with the City interests concerned arrangements to ensure that this co-operation is effective.

I come to my last theme, the City and industry. It seems to me that relationships between them could be much improved with advantage to both and to the country. There are, of course, innumerable excellent connections between individual companies and their bankers and others, but the predominant sense remains one of wariness and some gap of sympathy and understanding. It will not be easy to overcome. We in the City must make the approaches.

You will recognise that I bring this preoccupation with me from my former life, in particular as Chairman of the Industrial Development Advisory Board (where I am glad to say another banker has followed me) and I shall be happy if in my present office I can play a part in helping better understanding. It gives me pleasure to say that the proposed merger between the Finance Corporation for Industry and the Industrial and Commercial Finance Corporation, which my predecessor initiated, is now likely to be consummated. The Bank will have a substantial stake in the new group which will have a sizable capacity to extend its activities as circumstances require. I do not wish to make exaggerated claims for its enlarged rôle — time will provide the judgment there — but it is tangible evidence of the desire of the clearing banks and ourselves to make an extra contribution to the financing of industry.

My Lord Mayor, I have touched on a wide range of subjects tonight; monetary policy and its framework; the City and Europe; and the relations between the City and industry. All these will be areas of continuing effort. We shall aim to be open-minded, to encourage dialogue and to co-operate fully with all those whom we can help and serve.

I close on a personal note. I came to the City late and from practice at the Bar and I think I can see it plain, warts and all. It stands supreme among the financial capitals of the world, in skill, innovation and in readiness to respond to any public call. I feel nothing but pride in being able, on behalf of its bankers and merchants, to reply to this toast tonight.